

BOOK REVIEW

LAW AND INFLATION. By Keith S. Rosenn. Philadelphia: University of Pennsylvania Press, 1982. Pp. xxxix, 451. Price \$40.00.

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Most educated people today are aware of the constant depreciation in the value of money, and of the effect it may have on their financial position. Most lawyers, too, are aware of a number of awkward corners in the law which make it necessary for them to consider the impact of future inflation when advising clients or drafting contracts. *Law and Inflation*¹ is one of the first attempts to put all this together in an interesting and informative way. Professor Rosenn tells us a great deal about the problems inflation can create for lawyers and their clients, and about the ways in which they can try to cope with those problems. He also tells us a good deal about the theoretical and historical background of inflation, about the experiences of countries that have suffered particularly severe inflation, and about how they have attempted to deal with it.

The scope of the book is impressive, as can be seen by glancing at the Table of Cases and the Table of Statutes. Although the total number of cases and statutes cited is not large, the countries from which they are drawn include Argentina, Brazil, Chile, France, Germany, Great Britain, Israel, and Switzerland, as well as, of course, the United States. The exposition of the subject also extends into history, guiding the reader through the disastrous inflations of Germany after World War I and Hungary after World War II, though most of the emphasis is on present-day problems.

The first three chapters of the book serve as an introduction in which the author takes us through the familiar rival theories of the causes of inflation espoused by economists and politicians of varying hues. He concludes that inflation is likely to be with us into the foreseeable future, though not necessarily at galloping rates. He insists that inflation rates will be controlled because of anti-inflationary tendencies in most countries. "Most people," he asserts, "regard inflation as an

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¹ K. ROSENN, *LAW AND INFLATION* (1982).

evil, even though they may be profiting from it in certain ways, and will oppose political groups that advocate blatantly inflationary policies."²

This assertion may be open to question, because inflation gives some people the opportunity to profit at the expense of others (just as the market gives some people the chance to do well) depending on the whole complex of institutional and legal forces at work. Persons whose employment enables them to count with some confidence on being able to maintain their purchasing power are bound to be able to profit from inflation—at least until retirement, when difficulties may arise. Today (at least in Britain) the expansion of owner-occupation in housing, despite relatively high interest rates, means that a large body of the community will have a significant interest in perpetuating inflation. With tax relief available on mortgage interest, even interest rates of twelve percent or fourteen percent have in recent years been well below the general rate of inflation, and still further below the increase in house prices which seems to outstrip increases in other prices. Furthermore, so many people have reasonable expectations of maintaining the purchasing power of their incomes that few are troubled by fear that inflation will hurt them. Even retired pensioners in modern Britain are often protected from inflation since all who draw pensions from the state (which includes virtually the entire working class, plus all middle class employees of one or another of the state's industrial, administrative, or social institutions) have now won the right to automatically indexed pensions. Virtually the only group that is visibly hurt by inflation are those retired persons who have no claim at all on the state and who worked throughout their lives in private employment; this is (needless to say) a much smaller proportion of the population in Britain than in the United States.

Of course, inflation may hurt the body politic in ways that are not immediately apparent, and Professor Rosenn discusses some of these hidden costs of inflation—additional transaction costs,³ for instance, or even the unwillingness of parties to make long-term contracts at all.⁴ It is a pity he has said so little about the inequities arising from inflation, because I do not believe that inflation in democratic countries will be easily controlled unless and until people come to think of it as something that leads to fundamentally *unfair* results. It is easy enough to see who gains and who loses in relation to particular contracts, and it is also easy enough to have some rough idea of what happens in a disaster

² *Id.* at 16.

³ *Id.* at 130-31, 207.

⁴ *Id.* at 130-31, 167.

such as total collapse of the currency; but it is much more difficult to work out the general distributive implications of continuous inflation among various groups in society. The author might well have devoted more attention to that question.

The core of the book concerns specific legal questions that arise from changes in the value of currencies. Chapter 4 deals with legislative and judicial revision of inflation-distorted contracts, and chapter 5 deals with the planning of contracts so as to take advance account of inflation. Chapter 6 discusses the special problems presented by certain long-term contracts, chapter 7 discusses damages in contract and tort actions, chapter 8 discusses international valuation problems, and chapter 9 discusses the income tax and inflation. A survey as broad as this cannot hope to provide enough detail to deal with specific problems in full, although the three chapters on domestic contracts are very good and almost exhaustive.

The discussion of the German experience is particularly interesting, with its account of the famous case of *St. v. R.* in which the German courts imposed some revalorization on contracts after the currency collapse in 1923.⁵ The author quotes the totally opposed views of Professor Dawson⁶ and Professor Nussbaum⁷ about the German experience with revalorization. While admitting that courts are ill-equipped institutionally for such a massive task, the author seems favorably inclined toward this attempt to salvage some measure of justice after the collapse of the currency.⁸ He is, however, less favorably inclined toward judicial attempts to intervene in contracts affected by inflation of a less drastic character, pointing out that in modern times some degree of inflation must be anticipated by nearly all contracting parties, and that the real problem is therefore to distinguish between anticipated and unanticipated inflation.⁹ Moreover, changes in prices may be due only partly to inflation; clearly, they may also arise from normal market forces affecting different goods in different ways.¹⁰ Here too the problems of trying to factor out the inflationary from the noninflationary price changes are almost insuperable. Then again, common law

⁵ See *id.* at 90-93.

⁶ *Id.* at 93 ("a landmark in German legal history and a fitting climax to the magnificent work of the Reichsgericht in guiding a great nation through its darkest hours") (quoting Dawson, *Effects of Inflation on Private Contracts: Germany, 1914-1924*, 33 MICH. L. REV. 171, 205 (1934)).

⁷ K. ROSENN, *supra* note 1, at 93 ("thoroughgoing judicial aberration and confusion") (quoting A. Nussbaum, *MONEY IN THE LAW NATIONAL AND INTERNATIONAL* 210 (rev. ed. 1950)).

⁸ See K. ROSENN, *supra* note 1, at 93.

⁹ *Id.* at 111-12.

¹⁰ See *id.* at 111.

doctrines like frustration and impossibility are blunt instruments for dealing with inflation: the only sensible role for the courts—if there is one at all—is to revalorize contract prices, not to declare contracts void or to set them aside.

The chapter on damages, and especially the section dealing with damages in personal injury cases, is perhaps less satisfactory. The chief problem posed by inflation in this area is that of assessing damages for future earnings losses, and the author seems to think that the present practice (of discounting future earnings while generally ignoring the impact of future inflation) is unduly hard on plaintiffs. The best solution, he suggests, is to abandon the discounting of future earnings and simply multiply the earnings loss by the relevant number of years.¹¹ In this connection he notes that “empirical evidence” suggests that recipients of large damage awards dissipate their damages in a short period.¹² Although I would not suggest that recipients of large awards of damages always use their awards sensibly, I believe that there is insufficient empirical evidence to support a conclusion that plaintiffs rapidly deplete their damage awards.¹³ The conclusion to be drawn from our experience with lump-sum damage awards is surely not that damages for personal injury should be raised even higher than they are already, but that, at least in serious cases, some system of periodic payments should be introduced. Even this solution, of course, involves a measure of paternalism because nothing currently prevents a plaintiff from using his or her lump-sum award to buy an annuity. It is true that insurance companies are not prepared to sell fully indexed annuities, because they have no access themselves to fully indexed securities to cover such liabilities. Given the anticipation of inflation, however, even a non-indexed annuity provides a higher income than would be the case

¹¹ See *id.* at 232-33.

¹² *Id.* at 234.

¹³ Rosenn cites two sources for his proposition. *Id.* at 259 n.83. One source is a statement of a former English Chief Justice, Lord Parker, referring in 1965 to the results of a survey of some cases from the North of England which indicated that “all those who had recovered five figure damages were drawing National Assistance in a matter of a few years.” Parker, *Compensation for Accidents on the Road*, 18 CURRENT LEGAL PROBS. 1, 5 (1965), cited in K. ROSENN, *supra* note 1, at 259 n.83. When I was writing my book, *Accidents, Compensation and the Law* in 1968, I wrote to Lord Parker asking him for a reference to the study he had cited, only to be told that this was something he had heard many years ago and he had no additional record of it. An exhaustive search failed to reveal any trace of the empirical data.

Rosenn's other citation is to an article by Harvey McGregor. K. ROSENN, *supra* note 1, at 259 n.83. McGregor, however, also offers no empirical data for the proposition that plaintiffs quickly dissipate their damage awards. See McGregor, *Personal Injury and Death* in 11 INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW ch. 9, §§ 55, 86, at 23 & n.180, 34 (bound volume forthcoming).

with a stable currency. Of course this is not wholly satisfactory for plaintiffs because they cannot protect themselves against the declining purchasing power of their annuities over many years. Still, they could, to some extent, guard against such declines by a prudent investment policy. And insofar as they are left unable to protect themselves against all risks, the answer must surely lie with government, rather than with defendants who would then bear responsibility for still higher damages.

If inflation continues indefinitely at the levels we have been experiencing in recent years, it will surely have to be recognized eventually that only government can solve these problems, either by taking over the responsibility for dealing with the long-term disabled (and financing their care through pay-as-you-go methods which eliminate the inflation problem), or by providing adequate indexed securities to insurers who can then be expected to offer indexed annuities in the market. In any event, it is a mistake (inevitable, perhaps, in a book of this nature) to concentrate exclusively on the inflation problem for personal injury victims, without regard to the broader social and legal context of the personal injury action. Specialists in personal injury law might argue, for instance, that tort plaintiffs are already so exceptionally well treated by the law, compared with those accident victims unable to recover damages, that any further increase in the level of damages would have totally unacceptable distributive implications.

The concluding chapter discusses the possibility of indexing all contracts, debts, and legal liabilities, and suggests, on the basis of the experience of Brazil, Finland, and Israel, that a broad system of indexing is quite feasible. Rosenn, however, points out certain dangers in these attempts at universal indexation, prominent among which is the temptation provided to governments to manipulate the index—a temptation to which all three of these governments have partly succumbed.¹⁴ He also explains how, and why it is necessary, to exclude certain factors from some of the critical indexes; for example, a wage index must factor out price increases resulting from the increased cost of imports or from natural disasters such as harvest failures.¹⁵ Such events involve a real loss in wealth to the community against which it is impossible that everyone can be protected. Unfortunately, these subtleties are likely to be lost on most workers and their unions who have, in many countries, come to see wage indexation as a guarantee that their earnings will not suffer a decline in purchasing power.

Rosenn also advocates a fundamental change in contract law: in

¹⁴ K. ROSENN, *supra* note 1, at 388.

¹⁵ *Id.* at 389-90, 401.

any contract to be performed over a year, indexation should be the norm unless specifically excluded by the parties.¹⁶ This would, he argues, "red flag" the inflation risk, compelling the parties to think about the consequences.¹⁷ Much as one may sympathize with the basic objective behind this proposal, the practical difficulties entailed seem enormous. First, the reference to contracts "to be performed over more than a one-year period"¹⁸ is unhappily reminiscent of the similar provision in the Statute of Frauds, a provision which has given rise to a vast amount of litigation.¹⁹ What exactly is a contract to be performed over more than a one-year period? Does it include a contract of a continuing character (a lease, an employment contract) which may or may not last indefinitely? Does it include indefinite contracts which are determinable? Furthermore, suppose one party performs well in advance of the other who is to perform perhaps a year later. If the first party is the paying party there seems no case for indexing anything, except presumably the damages awardable for breach of the other party's obligations, which is a rather different matter. Indeed, the normal rule of contract law that the breaching party is liable to pay damages representing the value of the promised performance at the time of breach²⁰ itself carries its own indexing device. Then again, formidable difficulties would surely follow from Rosenn's proposal in trying to decide in all sorts of particular circumstances whether the contract shows an adequate implied intent to exclude index linking. Consider, for instance, a contract between an author and a publisher whereby the publisher agrees to pay a royalty calculated as a percentage of the published price of the book.

¹⁶ *Id.* at 394.

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ See generally 2 A. CORBIN, CORBIN ON CONTRACTS §§ 444-459 (1950 & Kaufman Supp. 1982).

²⁰ The general rule has been set out in the following terms:

In discussing the measure of damages for breach of an obligation, the endeavor must first be to determine the extent of the injury at the time of the breach, and then to consider whether added damages must be awarded for the delay which necessarily elapses between the time of the breach and the time of the beginning of the action or the time of the trial.

11 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 1413, at 621 (3d ed. 1968); see also *id.* § 1385, at 415 ("[T]he proper rule is: The measure of damages, in the absence of special circumstances showing proximate damages of a greater amount, is the difference between [the contract price and] the market or current price of the goods at the time or times when they ought to have been delivered.").

Indeed, in England and the Commonwealth there are now signs of a move to permit measurement of damages at a date later than that of breach, which entails extension of the indexing effect of damage awards. See Feldman & Libling, *Inflation and the Duty to Mitigate*, 95 LAW Q. REV. 270, 270-71 (1979); Waddams, *The Date for the Assessment of Damages*, 97 LAW Q. REV. 445, 460 (1981).

This contract may subsist over many years, so it would presumably fall within the scope of Rosenn's proposal. But remuneration by percentage of price is itself a form of index linking, so there is no case for any interference with this contract. No doubt in a simple case like this judges would readily hold that there is an "implied intent" to exclude the revalorization to be provided for by Rosenn's statute. Nonetheless, the example demonstrates the difficulties likely to be involved in the proposal. It would surely be more sensible to proceed far more cautiously toward indexing contract prices, distinguishing in the first instance between different types of contracts and dealing with them class by class. In this connection it may also be found necessary to distinguish between consumer and commercial contracts. Great care would surely have to be taken before introducing indexing *against* consumers, given the very real danger that many consumers would enter into contracts without appreciating the possible impact of indexing. On the other hand, most participants in commercial contracts can probably be left to take care of inflation by their own provisions.

Then again, consider this scenario: *A* contracts to provide *B* with a continuing service at a charge of \$100 per year for a period which may extend for several years. The Rosenn statute would therefore apply after the first year unless excluded. But the service charge of \$100 may, and indeed probably does, already take account of inflation over the period of the contract. Suppose the parties anticipate inflation of ten percent. The charge may have been about \$95 if the parties had anticipated a stable currency. When the charge falls to be revalorized under the Rosenn statute at the end of year 1, what is the base from which the court is to proceed? Is the base to be \$100, which is then adjusted by the changes in the index during year 2? Or is the base to be \$95, which is then adjusted by changes in the index over years 1 and 2 together? The former may well be regarded as unfair if the rate of inflation during year 1 turns out to be very different from that anticipated by the parties; on the other hand, the latter course requires the court to perform the difficult task of estimating a base charge depending on what it finds the parties to have anticipated by way of inflation in year 1. The difficulties seem enormous and endless, and the proposal would surely require much more careful study of its possible impact in a variety of different situations before it could be supported.

It would be wrong, however, to give the impression that this book stands or falls by this one proposal, important though it is. The book is packed with interesting information for lawyers, though one might wish that the message that came through was the importance of greater

determination in fighting inflation, rather than in learning how to live with it.